No. 99-1792

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IN THE

Supreme Court of the United States

DIRECTOR OF REVENUE OF MISSOURI,

Petitioner,

v.

COBANK ACB, AS SUCCESSOR TO THE NATIONAL BANK FOR COOPERATIVES,

Respondent.

On Writ of Certiorari to the Supreme Court of Missouri

BRIEF OF THE AMICUS CURIAE AMERICAN BANKERS ASSOCIATION IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether Congress, when it made technical changes to the Farm Credit Act in 1985, purposefully intended to confer broad state tax immunity upon privately owned, nontaxpayer-funded, profit-making Farm Credit System lending institutions.

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BRIEF OF THE AMICUS CURIAE[1] AMERICAN BANKERS ASSOCIATION IN SUPPORT OF PETITIONER

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[1] No counsel for any party had any role in authoring this brief and no person other than amicus curiae made any monetary contribution to its preparation or submission. Sup. Ct. R. 376.

In accordance with the provisions of Rule 37.3(a) of the Supreme Court Rules, the American Bankers Association respectfully submits this brief as amicus curiae in support of the Petitioner. Both parties have consented to this filing and their written consents are filed together with this brief.

INTEREST OF THE AMICUS CURIAE

The American Bankers Association is the principal trade association of the banking industry in the United States, representing banks in each of the fifty states and the District of Columbia, including both national and state-chartered banks. The Association membership includes community, regional, and money center banks, as well as bank holding companies, savings associations, trust companies and savings banks, with combined assets totaling over ninety percent of all banking assets in the United States.

The decision of the Supreme Court of Missouri involves the tax status of three production credit associations (PCAs) and the last remaining agricultural credit bank and bank for cooperatives (CoBank). The precise issue in this case has created considerable controversy within the banking community and courts in various states have differed sharply in their decisions. We believe that the appropriate tax status of these Farm Credit System (FCS) lending institutions raises fundamental legal and public policy tax issues of substantial importance to the commercial banking industry - agricultural banks in particular. PCAs and CoBank are direct retail lenders, no longer owned by the United States government, and serve no governmental role or function warranting an exemption from state and local taxation. Yet, the Supreme Court of

Missouri relied solely upon the institutions' classification as a federal instrumentality to justify tax immunity in this case. Such a narrow interpretation of the Supremacy Clause ignores clear legislative intent and would have a profound impact on the banking industry.

The American Bankers Association believes that the views of the banking industry will assist the Court in deciding the merits of this case. If broad tax immunity is upheld in this case, the unique competitive advantages that currently exist for FCS lending institutions would be unnecessarily strengthened at the expense of other similarly-situated taxpaying financial institutions. Undeniably, PCAs and CoBank are private, commercial, profit-generating, retail lending institutions. Since the 1960's, the United States has held no ownership interest in these institutions and state taxes have been imposed and collected. PCAs and CoBank should continue to legally assume their fair share of responsibility for the cost of state governments, whose benefits they receive and whose protection they enjoy.

SUMMARY OF ARGUMENT

This case involves the proper interpretation of 12 U.S.C. sections 2134 and 2077, and the extent to which certain privately owned, profitable, FCS lending institutions should benefit from a constitutional immunity from state taxation.

Under 12 U.S.C. section 2134, Congress designated banks for cooperatives as federal instrumentalities and exempted the notes, debentures, and obligations issued such banks for cooperatives from all taxation (except surtaxes, estate, inheritance, and gift taxes); section 2077 provides a

similar designation and exemption for a production credit association's notes, debentures, and obligations. Prior to the Farm Credit Act of 1985, special income tax language was contained in each of these sections. This language provided an income tax immunity for the PCAs and CoBank that was contingent upon a continued ownership interest by the United States government. However, the United States divested ownership in both PCAs and CoBank. Thus, since 1971, the tax exemption has not been applied and both PCAs and CoBank have been subject to and paid applicable nondiscriminatory state and local taxes.

In certain circumstances, the Supremacy Clause should permit courts to review legislative history, all relevant facts, and to set appropriate limits on state taxation consistent with congressional intent. Based upon the legislative history of the 1985 changes to 12 U.S.C. sections 2134 and 2077, it is clear that Congress did not intend to purposefully remove the government ownership tax contingency language and to provide a blanket tax immunity for PCAs and CoBank. The changes that occurred in 1985 were unrelated to the tax status of these FCS lending institutions. Instead, the changes were considered "technical and conforming." Thus, the Supreme Court of Missouri ignored clear legislative intent to subject PCAs and CoBank to state income taxation.

Both PCAs and CoBank function much like and engage in the same activities as other private taxpaying financial institutions. Further, PCAs and CoBank are increasingly benefiting from less restrictive regulations to the detriment of competitors offering comparable financial services. If the Court upholds the decision of the Supreme Court of Missouri, the competitiveness of the agricultural lending market would be threatened and Congress'

continuing desire to transform the FCS from a government system to a privately-owned and controlled system would be compromised.[2]

ARGUMENT

I. THE DECISION OF THE SUPREME COURT OF MISSOURI IGNORES CLEAR CONGRESSIONAL INTENT TO SUBJECT PCAS AND COBANK TO STATE INCOME TAXATION.

Though PCAs and CoBank are statutorily designated federal instrumentalities, Congress clearly intended to subject these specific FCS lending institutions to state income taxation. The FCS lending institutions are a vital component of a powerful nationwide network of lending institutions and financial entities within the Farm Credit System, which was initially created in 1916 pursuant to the Federal Farm Loan Act. *See* Pub. L. No. 64-158; 39 Stat. 360 (1916). This Act created twelve Federal Land Banks that were partially owned and funded by the Federal government. The current FCS is a result of several modifications made by Congress over the years in response to the needs of the agricultural lending market. The FCS is currently comprised of six farm credit banks and their 172 local associations (17 federal land bank associations, 57 production credit associations, 49 agricultural credit

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[2] H.R. Rep. No. 287, 86th Cong., 1st Sess. 1 (1959), *reprinted in* 1959 U.S.C.C.A.N. 2123.

associations, and 49 federal land credit associations), and one agricultural credit bank or bank for cooperatives (CoBank).[3]

In response to economic conditions during the Great Depression, banks for cooperatives (BFCs) and production credit associations were both created by the Farm Credit Act of 1933. *See* Pub. L. No. 73-98, 48 Stat. 257 (1933). CoBank ACB, which finances cooperatives and agricultural businesses nationally, is the successor in interest to the National Bank for Cooperatives and the sole remaining agricultural credit bank and bank for cooperatives after a series of mergers and consolidations.[4] CoBank is an $18.6 billion institution that provides lending to both individual borrowers and other cooperatives. Production credit associations, with total assets of over $7 billion, were created to provide short- and intermediate- term loans to farmers and ranchers. *See* S. Rep. 124, at 2 (1933). The average production credit association holds approximately $140 million in assets while the average agricultural bank holds $62.5 million in assets. PCAs and CoBank are also statutorily classified as "federal instrumentalities." 12 U.S.C. sections 1271 and 2141. As such, they are entitled to certain advantages, including those explicitly enumerated by statute.

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[3] *Farm Credit System, Annual Information Statement – 1999.* Published by the Federal Farm Credit Banks Funding Corporation on February 24, 2000.

[4] CoBank ACB was formed in 1995 from a consolidation of the National Bank for Cooperatives and two other entities. In 1999, the sole remaining independent bank for cooperatives also merged into CoBank.

In the Farm Credit Act of 1971, Congress made significant changes to the existing Farm Credit Act, including a number of revisions concerning the operation and structure of the FCS. *See* Pub. L. No. 92-181, § 2.17, 85 Stat. 583, 602 (1971). At that time, Congress retained the contingent tax exemption provisions affecting PCAs and CoBank.[5] Within the Farm Credit Act of 1971, the tax provisions for both PCAs and CoBank were identical:

> Each [production credit association or banks for cooperatives] and its obligations are instrumentalities of the United States. Such [production credit associations or banks for cooperatives], their property, their franchises, capital, reserves, surplus, and other funds, and their income shall be exempt from all taxation now and hereafter imposed by the United States or any State, territorial, or local taxing authority; ... except that any real and personal property of such [production credit associations or banks for cooperatives] shall be subject to federal, State, territorial, and local taxation to the same extent as similar property is taxed. The exemption provided in the preceding sentence shall apply only

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[5] The tax provisions for PCAs were formerly designated 12 U.S.C. § 2098 and now codified in 12 U.S.C. § 2077. It has remained essentially the same as the Farm Credit Act of 1933 as it relates to the provision for exemption from Federal, State and local taxation for notes, debentures, or other obligations issued by production credit associations, and the United States stock ownership contingency associated with the waiver from Federal, state and local income taxation.

> for any year or part thereof in which stock in the [production credit association or banks for cooperatives] is held by the Governor of the Farm Credit Administration.

Id. (emphasis added).

The two underlined sentences of the preceding paragraph were deleted during non tax-related technical and conforming amendments to the Farm Credit Act in 1985. PCAs and CoBank now claim that such changes created an even broader tax exemption than what was contained in the statute in 1971. While federal instrumentality status does confer special tax privileges, no implicit or explicit action was taken by Congress to purposefully create a broad tax exemption. Indeed, Congress' intent in the area of taxation was never questioned, especially since the government relinquished its ownership interest several decades ago. A Congressional Committee report described the removal of United States government ownership contingency language as a technical amendment. *See* H.R. Rep. No. 425, 99th Cong., 1st Sess. 5 (1985), *reprinted in* 1985 U.S.C.C.A.N. 2587, 2591. These technical amendments contained in the Farm Credit Amendments Act of 1985 included changes to the powers and duties of the Farm Credit Administration and the replacement of the Governor of the Farm Credit Administration with a three-member board. *See generally Colorado Springs PCA v. Farm Credit Admin.*, 967 F.2d 648 (D.C. Cir. 1992). Therefore, no substantive tax changes were made nor intended by Congress in 1985.

As a result of the 1985 changes, the waiver of tax immunity language in the statute was omitted from the text. Although Congress did retain language subjecting interest on obligations to Federal income taxation in the hands of

the holder, nothing in the legislative history of this Act indicates an intent or even a remote mention by Congress to create a sweeping income tax immunity for PCAs and CoBank. Hearings most likely would have been held or notations made by the appropriate committees of jurisdiction or even individual members of Congress if such broad tax immunity was intended to be congressionally created.

Since *McCulloch v. Maryland,* 17 U.S. 316 (4 Wheat.) (1819), it has been clear that states are without power to tax federal instrumentalities under the Supremacy Clause of the United States Constitution unless this immunity is otherwise waived by Congress. *See, e.g., First Agric. Nat'l Bank of Berkshire v. State Tax Comm'n*, 392 U.S. 339, 340 (1968); *Department of Employment v. United States*, 385 U.S. 355, 358 (1966); *Federal Land Bank v. Board of County Comm'rs*, 368 U.S. 146, 149 (1961); *United States v. County of Allegheny*, 322 U.S. 174, 176 (1944). If Congress is silent, then the Supremacy Clause would prevent a state from imposing taxes on a federal instrumentality. U.S. Const. Art. VI, cl. 2.

The Court of Appeals of New Mexico in *Production Credit Ass'n of Eastern N.M. v. Taxation & Revenue Dept,* 999 P.2d 1031 (N.M. Ct. App. 2000), *cert. denied*, 997 P.2d 820 (N.M. 2000), *petition for cert. filed,* 69 U.S.L.W. 3111 (U.S. July 28, 2000) (No. 00-156) did acknowledge a PCA's inherent immunity from state taxation, but did not find the statute following the 1985 technical amendments to be clear and unambiguous on the subject of tax immunity. In the face of ambiguity, the New Mexico appeals court in *Eastern New Mexico* found it necessary to determine legislative intent and held that "neither the 1985 Act nor its legislative history indicates

any intention by Congress to purposefully remove the long-standing waiver of immunity from privately owned credit associations." *Id.* at 1037.

For decades, PCAs and CoBank could not avail themselves of the statutory immunity from state and local taxation.[6] Why should PCAs and CoBank now be entitled to aggravate the spirit and protection intended to be afforded by the Supremacy Clause? In this case, it is obvious that the deletion of the contingency language in 12 U.S.C. sections 2134 and 2077 in 1985 did not translate into purposeful Congressional silence with the intent to provide a broad tax immunity to PCAs and CoBank. It hardly seems plausible that Congress, by deleting unnecessary language in 1985, intended to enlarge the scope of immunity for PCAs and CoBank. Congress' intent concerning tax immunity for PCAs and CoBank is clear in this case. Therefore, when Congress makes statutory changes and does not purposefully or meaningfully indicate its intentions on a subject as substantive as tax immunity, congressional silence should not be presumed and the Supremacy Clause should not prevent further judicial inquiry into legislative intent.

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[6] It should be noted that, until recently, attempts by production credit associations in a claim of waiver from state taxation were unsuccessful. *See, e.g.,Baker Prod. Credit Ass'n v. State Tax Comm'n*, 421 P.2d 984 (Or. 1966) (en banc) ; *Woodland PCA v. Franchise Tax Board*, 37 Cal.Rptr. 231 (Dist.Ct.App.1964); *Montana Livestock PCA v. State*, 393 P.2d 50 (Mont. 1964); *Columbus PCA v. Bowers*, 180 N.E.2d 1 (Ohio 1962).

II. PCAs AND CoBANK ARE NEITHER THE FEDERAL GOVERNMENT NOR ITS LAWFUL INSTRUMENTALITIES.

Though statutorily designated as a federal instrumentality, PCAs and CoBank do not possess the attributes commonly understood and ordinarily associated with federal agencies. Black's Law Dictionary defines a federal instrumentality as "[a] means or agency used by the federal government. A government agency immune from state control." *Blacks Law Dictionary*, Fifth Edition (1983). PCAs and CoBank are not agencies *used* by the federal government and their structure, activities, and operations bear no relationship to that of a typical government agency.

A history of the state taxation of national banks illustrates the application of the tax immunity to instrumentalities *used* by the federal government. While state-chartered banks have usually been subject to state taxation, national banks were considered constitutionally immune from some forms of state taxation due to the unique role and function they once served. In the landmark case of *McCulloch v. Maryland*, *supra*, the Court established an implied constitutional tax immunity in a case involving a discriminatory tax assessed against the Second Bank of the United States. This case established the longstanding precedent preventing states from imposing taxes on federal instrumentalities. Though Congress may designate entities as federal instrumentalities that are accorded special tax benefits, the bank in *McCulloch* is clearly distinguishable from today's national banks, PCAs and CoBank. The Second National Bank of the United States in *McCulloch* was owned and controlled by the United States government. During that time, national banks

were true federal instrumentalities in the sense that they were owned and operated by the Federal government. The Court was also placed in an unenviable position of establishing judicial policy when the United States, "having only tiny revenues of less than $25 million, was quite weak in comparison with the relatively strong state governments."[7]

Over the years, however, the notion of banks as instrumentalities of the Federal government created for a public purpose has eroded even though the intergovernmental tax immunity doctrine, applied to a national bank as a federal instrumentality, was upheld in *First Agric. Nat'l Bank, supra*, 392 U.S. 339 (1968) (Marshall, J., dissenting). In holding that states are without power to tax national banks, unless authorized by Congress, the Court stated that "[b]ecause of pertinent legislation in the banking field, we find it unnecessary to reach the constitutional question of whether national banks should be considered nontaxable as federal instrumentalities. *Id.* at 341. In the case of PCAs and CoBank, the language in the statute concerning tax immunity is silent. However, Congress was not.

In determining whether a private entity should be treated as immune from state taxation, courts should analyze the entity claiming federal instrumentality privileges. PCAs and CoBank are completely private, profitable, retail lending institutions. In his dissent in *First Agric. Nat'l Bank*, Justice Marshall offered the following observation about national banks:

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[7] Paul J. Hartman, *Federal Limitations on State and Local Taxation,* § 6.4, at 247 (1981).

> ... a national bank cannot be considered a tax immune federal instrumentality. It is a privately owned corporation existing for private profit of its shareholders. It performs no significant federal governmental function that is not performed equally by state-chartered banks. Government officials do not run its day-to-day operations nor does the Government have any ownership interest in a national bank.

Id. at 354.

Though the ruling involved an unrelated jurisdictional issue under the Tax Injunction Act, in *Arkansas v. Farm Credit Serv. of Cent. Ark.*, 520 U.S. 821 (1997), this Court also recognized the private nature of PCAs. In delivering the opinion of the Court, Justice Kennedy wrote:

> [t]he PCA's' business is making commercial loans, and all their stock is owned by private entities. Their interests are not coterminous with those of the Government any more than most commercial interests. Despite their formal and undoubted designation as instrumentalities of the United States, and despite their entitlement to those tax immunities accorded by the explicit statutory mandate, PCA's do not have or exercise power analogous to that of the NLRB or any of the departments or regulatory agencies of the United States.

Id. at 831-832.

A similar analysis should be made with respect to CoBank

or, alternatively, for any private entity seeking a tax status consistent with that of a government-owned federal instrumentality. For example, in *Department of Employment v. United States*, 385 U.S. 355 (1966), the Court conferred federal instrumentality status on the Red Cross, even though it is a private entity, reasoning that a statute and Executive Order "devolved upon the Red Cross ... a wide variety of functions indispensable to the workings of our Armed Forces around the globe, and to assist the Federal vernment in providing disaster assistance to the States in time of need." *Id.* at 418. Sound legal analysis concerning the activities, structure, control, and ownership by the federal government were similarly performed in other cases before the Court. *See, e.g., Graves v. New York*, 306 U.S. 466 (1939); *United States v. Boyd*, 378 U.S. 39 (1964); *United States v. Township of Muskegon*, 355 U.S. 484 (1958). If such an examination were performed in this case, a different result may have been reached.

The tax status of federal credit unions is an important contrast to the varied applications of constitutional immunity extended to federal instrumentalities. Federal credit unions are granted a specific immunity from Federal and state taxation in 12 U.S.C. § 1768, without any corresponding congressional designation as a federal instrumentality. Such a contrast is significant because comparable financial service providers, including commercial bank lenders, savings institutions, federal credit unions, PCAs, and CoBank are similarly situated financial institutions, albeit serving their own

statutorily created public purpose.[8] Unlike these FCS lending institutions, however, the exemption from taxation for federal credit unions is clear and specific. The Federal Credit Union Act does not designate federal credit unions as federal instrumentalities, but they do enjoy explicit statutory tax advantages.[9] PCAs and CoBank, as statutorily declared federal instrumentalities, should not receive preferential tax treatment simply because they have apparently found a convenient loophole in the law.

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[8] Under 12 U.S.C. § 1752 (1), a federal credit unions is defined as "a cooperative association organized in accordance with the provisions of this chapter for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes."

[9] *Cf* Rev. Rul. 69-283; 1969 C.B. 156 (Federal credit unions are recognized as U.S. instrumentalities by the I.R.S. and are considered exempt under I.R.C. § 501(c)(1). However, since they are not wholly owned by the U.S., credit unions must file a Form 990 Annual Information Return).

III. CONFERRING BROAD TAX IMMUNITY TO PCAS AND COBANK WOULD HAVE A NEGATIVE COMPETITIVE IMPACT ON THE COMMERCIAL AGRICULTURAL BANKING INDUSTRY.

The structure and operations of the FCS are similar to the current commercial banking system in the areas of examination, enforcement, capital and compliance requirements, and regulatory powers. As noted earlier, the FCS consists of (1) the Farm Credit Administration, which is the primary federal regulator that examines and supervises all System institutions, (2) the Farm Credit System Insurance Corporation, which insures the principal and interest on the System-wide debt securities, and (3) the Federal Farm Credit Banks Funding Corporation, which manages the sale of System-wide debt securities. In addition, the FCS has six farm credit banks that act as wholesalers of funding to the retail lending associations. There are approximately 172 retail-lending associations deployed around the country. There is one agricultural lending bank (CoBank), which finances agricultural cooperatives and agricultural businesses nationally. Finally, there is Farm Credit Leasing (82% owned by CoBank) that makes retail and commercial sized leases for farmers, ranchers, rural consumers, and farm-related service businesses. In 1999, Farm Credit Leasing was recognized as the seventh largest independent leasing company in the United States and the 52nd largest leasing company overall with assets under management of more than $1.2 billion. This demonstrates that the FCS is a major lender in the financial services marketplace.

Although the number of institutions within the system has declined in the past decade, new regulations that removed many lending restrictions, and accelerated

consolidations have created larger and more powerful lending institutions.[10] Recently, the Farm Credit Administration announced that that they would accept applications from FCS institutions for national charters. 65 Fed. Reg. 45,066 (2000). National charters will remove long-standing geographic restrictions and allow, for the first time, FCS lending institutions to lend money anywhere in the country. In addition, it has been proposed by the Farm Credit Administration that FCS lending institutions be permitted to purchase 100% loan participations from non-farm credit system lenders. 65 Fed. Reg. 45,931 (2000). The Farm Credit Administration currently requires borrowers to purchase stock in Farm Credit System institutions. Now, FCS institutions can buy 100% of loans from banks and others, and there is no stock ownership requirement. Essentially, FCS is acting just like any other private correspondent bank. Commercial bankers, particularly agricultural banks, cannot compete in an FCS environment that offers unfair tax and regulatory advantages to these privately owned competitors.

Another unique competitive advantage enjoyed by PCAs and CoBank is their special government sponsored entity status (GSE). However, unlike other GSEs, such as the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Federal Home Loan Bank System, and the Student Loan Marketing Association, FCS lending institutions are direct retail lenders and fierce competitors of commercial banks. Their GSE status, which

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[10] *See, e.g.*, 62 Fed. Reg. 4429 (1997). In 1997, the Farm Credit Administration issued final regulations significantly expanding the scope and eligibility of the FCS's lending operations.

allows FCS institutions to access funds at near-Treasury rates, gives them a tremendous advantage over banks and other lenders.

Finally, the most profound effect of the decision of the Supreme Court of Missouri is the probable economic hardship such a blanket tax immunity would have on other comparable private section lenders, including banks. If the decision were upheld, the cost to PCAs and CoBank of conducting their retail lending businesses would be dramatically decreased. It logically follows that any legislative or judicial removal of any provision for taxes, without any corresponding public policy or compelling legal reason, would allow PCAs and CoBank to offer much lower rates on short- and intermediate-term loans and, in turn, provide private owners with a significant return on their investments to the detriment of similarly situated taxpaying commercial bank shareholders.

The Farm Credit System reported year-end total assets of $88.7 billion at the end of 1999. Its institutions recorded a profit of $1.23 billion in 1999, exceeding commercial farm banks on an average return on assets, and the percentage increase of total loans and assets. Yet, the most meaningful entry contained in the financial reports is the provision for state, local, and federal income taxes. For the year ending 1999, the FCS provision for income taxes was $172 million.[11] By upholding the lower court decision in the Supreme Court of Missouri, the FCS provision for taxes would be drastically reduced, thus creating a significant negative impact on competitiveness of the agricultural lending market. Surely, Congress did not

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[11] *See Farm Credit System Annual Information Statement – 1999*, *supra*, at 3.

intend such a result. Therefore, respondent's claim of immunity from taxation has noteworthy economic and competitive consequences that greatly outweigh any valid claim for constitutional immunity as a federal instrumentality.

CONCLUSION

There are no compelling legal justifications for conferring broad state tax immunity upon PCAs and CoBank. For the reasons cited above, the decision of the Supreme Court of Missouri should be reversed.

Respectfully submitted,

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